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Mayer, Brown, Rowe & Maw LLP  
1675 Broadway  
New York, New York 10019-5820

Main Tel (212) 506-2500  
Main Fax (212) 262-1910  
www.mayerbrownrowe.com

Jennifer L. Sawin, Esq.  
Assistant Director  
Division of Investment Management  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

**Michael R. Butowsky**  
Direct Tel (212) 506-2512  
Direct Fax (212) 849-5512  
mbutowsky@mayerbrownrowe.com

**Re: Comments re Proposed Rule for Investment Adviser Code of Ethics,  
File No. S7-04-04**

Dear Ms. Sawin:

Thank you for giving us the opportunity to respond to the proposal of the Commission to require that all registered investment advisers maintain a code of ethics (the "Proposal"). *See Proposed Rule: Investment Adviser Code of Ethics*, SEC Rel. No. IA- 2209 (Jan. 20, 2004). As you know, one portion of the Proposal would revise the recordkeeping requirements applicable to investment advisers.

We are writing on behalf of our client, Capri Capital Advisors, LLC ("Capri"), a registered investment adviser that specializes in real estate investments. For the reasons set forth below, we believe that the Commission should continue its longstanding policy of exempting registered investment advisers that focus on real estate investments for their clients from collecting and reviewing the details of the personal securities transactions of its employees and other persons. Related to that, we believe that the Commission should permit "Real Estate Managers," as defined below, to craft codes of ethics that would apply to their business, as opposed to the business of a conventional investment adviser, e.g., one that recommends that its clients invest in publicly-traded securities of public reporting companies purchased and sold on national securities exchanges.

#### Background\*

As mentioned, Capri is an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). All of its advisory clients are institutional in nature, including pension funds and university endowments. Capri specializes in real estate

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\* The factual information described herein concerning Capri is based on information supplied to us by Capri.

investments, and invests client assets only in commercial real estate, interests in real estate (such as joint venture interests in real properties), ownership interests in closely-held (and not publicly-traded) real estate companies, and loans secured directly or indirectly by interests in real estate or privately-held real estate companies. A typical commercial real estate acquisition, for example, would be a multi-unit apartment building that would cost millions of dollars. Capri does not invest client assets in conventional securities—e.g., common stock, preferred shares, bonds—for any of its clients. It also does not manage investment companies.

Rule 204-2(a)(12) under the Advisers Act currently requires that each registered investment adviser keep records of every transaction in a security in which it or its advisory representatives have any direct or indirect beneficial ownership. The Commission has long recognized that investment advisers that focus on real estate should be treated differently from other investment advisers regarding the personal securities transactions of employees and other persons. In *McMahan Real Estate Advisers, Inc.* (SEC No-Action Letter, pub. avail. June 13, 1988), the Staff of the Commission exempted a manager from these recordkeeping requirements, based on the following facts and representations:

- The manager was registered with the Commission because some of the real estate-related investments under its management might be deemed to be securities under the Advisers Act;
- The manager only gave advice with respect to real estate investments, and did not give advice as to stocks, bonds, or similar securities;
- No securities exchange or other established trading market existed for the real estate investments;
- Investments were purchased or sold by clients directly from or to the buyers or sellers, respectively, in negotiated transactions; and
- The advisory representatives of the manager only on occasion made investments in the kind of real estate assets as to which the manager renders advice; in such a case, the manager would make full disclosure of this relationship and keep records in accordance with Rule 204-2(a)(12).

The Staff has granted similar relief in at least three other no-action letters.<sup>1</sup> In doing so, it appears that the Staff took into consideration the purposes underlying the recordkeeping

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<sup>1</sup> *Aetna Realty Investors, Inc.* (SEC No-Action Letter pub. avail. Jul. 11, 1986); *L.J. Melody & Co.* (SEC No-Action Letter pub. avail. Jan. 22, 1988); and *Westmark Real Estate Investment Services* (SEC No-Action Letter pub. avail. Jul. 31, 1989). We note that each requestor (including McMahan, and, here, Capri) has a slightly different description of the exact nature of its commercial real estate business, but consistent in all of the descriptions is the focus on commercial real estate, interests in real estate, and loans and mortgages secured by commercial real estate. We use the term “Real Estate Direct Investments” herein to refer to the types of investments these managers (including Capri) would recommend for their clients, and the term “Real Estate Managers” to refer to registered

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requirement: i.e., that advisers may not breach their fiduciary duty to clients by “trading ahead” of them, or taking an investment opportunity away from them, or otherwise profiting from the investment advice rendered to them. It also appears that, at the same time, the Staff considered the business of real estate advisers, and concluded that such breaches would not result from using securities brokers to purchase or sell conventional securities such as common stock. To the extent that breaches could occur in the atypical instance in which advisory representatives would make real estate investments, the manager would comply with the Rule, as indicated in the last bullet point above.

### The Proposal

In its Proposal, the Commission seeks to require that all registered investment advisers maintain a code of ethics, and seeks to revise the recordkeeping rule described above to ensure that they keep records consistent with their code of ethics. For example, the Proposal would call for registered investment advisers not only to keep copies of records of the personal securities transactions of advisory representatives (the current law), but also to establish a code of ethics that would require the review of such records and the reporting of any violations of the code. The Proposal also calls for more formal delivery of such records by the representatives: they would provide copies of initial and annual holdings, periodic transaction reports, and where appropriate, duplicate broker confirmation statements.

We request that, when the Commission crafts the final rules that would require investment advisers to establish codes of ethics, it take into consideration the principles underlying *McMahan* and the other no-action letters referred to above, i.e., that Real Estate Managers should be permitted to craft codes of ethics that suit their business, and not require them to comply with provisions that would apply to conventional investment advisers.

We now look at the details of the Proposal—specifically, those items of the Proposal dealing with Personal Securities Transactions (Item II.C. of the Proposal)—and point out items that we believe should not be applied to our client:

1. Personal Trading Procedures. The Proposal calls for pre-clearance procedures, maintenance of restricted lists, imposition of blackout periods, and the like. The procedures would apply to all securities transactions of advisory representatives. Consistent with *McMahan*, we believe that, in the context of Real Estate Managers, such procedures should be limited to the

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investment advisers whose business is to recommend, and acquire, dispose of and hold Real Estate Direct Investments on behalf of their clients. In addition, consistent with the precedent, we do not seek to create a “frozen” list of items that would constitute Real Estate Direct Investments, but rather request that the term be given its common-sense meaning to cover direct investments in real estate. The term would also be limited to those transactions that satisfy the precedent cited in the bullet points above, i.e., transactions for which no securities exchange or other established trading market existed, and transactions effected directly from or to the buyers or sellers, respectively, in negotiated transactions.

potential acquisition in or disposition of Real Estate Direct Investments by a representative. This would permit the manager to focus on the types of investments where conflicts of interest would arise, or potential breaches of fiduciary duty could occur.

In addition, because private commercial real estate transactions are negotiated in a manner decidedly different from how publicly-traded securities trade (as indicated in the bullet points above describing *McMahan*), we believe that, at most, a Real Estate Manager should only be required to establish pre-clearance procedures, and not be required to comply with the other procedures described in this portion of the Procedures (including restricted lists and blackout periods). In that way, the manager would have time to address any potential conflicts of interest that may result in an employee's investment, and also would give it time to disclose the transaction as appropriate.

2. Persons Subject to Reporting Requirements. We have no comments on this part of the Proposal, with respect to how it would impact Real Estate Managers.

3. Reportable Securities and Beneficial Ownership. This portion of the Proposal would exempt money market instruments and money market funds from the list of securities to be pre-cleared and reviewed, on the grounds that they "would appear to present little opportunity for the type of improper trading that the access person reports are designed to uncover." Here, the Commission is reiterating the view expressed in *McMahan*, i.e., that the rules should be applied flexibly to take into account both the purposes underlying the requirement for a code of ethics and the particular business of the adviser. In this section, the Commission asked if there are other types of mutual funds that should be included on this exempt list. Our response, with respect to Real Estate Managers, is that they should continue to be permitted to rely on *McMahan*, and should not be required to report trades in transactions not involving Real Estate Direct Investments.

4. Reporting in Investment Company Shares. This portion would require the reporting of transactions in investment companies managed by the adviser. As mentioned, Real Estate Managers do not manage investment companies, and so this would not apply to them. Accordingly, our client has no comment on this part of the Proposal.

5. Initial and Annual Holding Reports. This would require employees and other representatives to provide the manager with a list of all of their holdings once at the time they become a representative (e.g., when they commence employment) and then once per year. Our only comment is that, with respect to Real Estate Managers, such reporting should be limited to transactions involving Real Estate Direct Investments.

6. Periodic Transactions Reports. This would require the advisory representatives to report all of their securities transactions at least quarterly. As with No. 5 above, our only comment with respect to Real Estate Managers is that such reporting should be limited to Real Estate Direct Investments.

7. Duplicate Broker Confirms and Statements. As mentioned in *McMahan*, the representatives would not use securities brokers or national securities exchanges to effect any Real Estate Direct Investments for their own behalf. Accordingly, this portion of the Proposal would not apply to them, and so our client has no comment on this part of the Proposal.

The Proposal also covers other topics besides personal securities transactions, and we address each point briefly here:

- Item II.A.—Standards of Conduct and Compliance with Laws. We have no objection to a requirement that Real Estate Managers establish a code of ethics that sets forth the standard of conduct for supervised persons. The Commission should expect, however, that this code will be much different from (and shorter than) a code established by a conventional adviser, i.e., one that invests primarily in publicly-traded securities rather than Real Estate Direct Investments.
- Item II.B.—Protection of Material Nonpublic Information. This portion of the Proposal would require advisers to restrict access to client information to a “need to know” basis, and references advisers’ obligations under Section 204A of the Advisers Act regarding such policies. We have no objection to this requirement, except to point out that, as a general matter, more people (including not only a larger group of people within the adviser’s organization, but also the adviser’s outside lawyers, accountants, appraisers, engineering and other consultants, and others directly involved in the transaction) need to know about pending commercial real estate transactions than need to know about pending securities transactions, as it generally takes a great many more people to originate, identify, investigate, analyze, evaluate, approve, negotiate, document and complete the transaction (and the transaction takes longer to complete). Accordingly, Real Estate Managers should be permitted to disseminate confidential information among a wider group of persons.
- Item II.D.—Initial Public Offerings and Private Placements. This would require pre-approval for a representative to invest in IPOs and private placements. Consistent with *McMahan*, we would have no issue with this requirement, so long as it is limited to pre-approval of initial public offerings and private placements involving Real Estate Direct Investments.
- Item II.E.—Reporting of Violations. This would require prompt internal reporting of violations. Our only comment is that, with respect to Real Estate Managers, such reporting should be limited to transactions involving Real Estate Direct Investments.
- Item II.F.—Acknowledged Receipt of Code of Ethics. We have no issue with the requirement that advisory representatives acknowledge receipt of the code of ethics, and annually recertify such acknowledgement.

- Item II.G.—Other Code of Ethics Provisions. Real Estate Managers should have the flexibility to establish a code of ethics that would be applicable to their course of business. Some of the examples cited in the Proposal—policies regarding gifts, discussion of penalties for violating the code—would seem to be relevant to Real Estate Managers. Others, such as procedures regarding the periodic review of the code, would be relevant, too, but would be more appropriate if the manager could determine what constitutes “periodic.” A Real Estate Manager needing only to review, at most, a handful of commercial real estate transactions by a few employees generally would not need to review its code as frequently as a conventional adviser, whose advisory representatives trade in the kind of common stock and other securities that the investment adviser recommends for investors.

### Conclusion

We believe that Real Estate Managers should be permitted to tailor their codes of ethics to cover their business, and not the business of a conventional investment adviser. We urge the Commission to confirm this extension of the concepts announced in *McMahan* in the final release of the Proposal.

Finally, we believe the approach described above would help Real Estate Managers focus on their core business, and not divert time and energy to reviewing transactions that do not present potential conflicts of interest and breaches of fiduciary duty.

We thank you for taking the time to consider our views. Please do not hesitate to contact me at (212) 506-2512, if you have any questions.

Sincerely,

/s/ Michael R. Butowsky  
Michael R. Butowsky